NEWS & ANALYSIS

Credit implications of recent worldwide news events

US Public Finance

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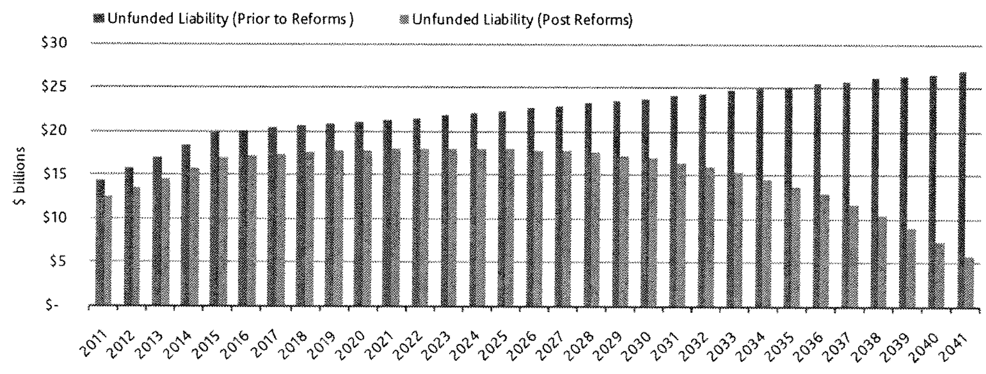
South Carolina's $2 Billion Pension Liability Reduction Is Credit Positive for State and Local Governments

Last Tuesday, actuaries for the state of South Carolina (Aaa stable) determined that recently enacted public pension reform legislation reduces the South Carolina Retirement System's (SCRS) current unfunded liability to $12.4 billion from $14.4 billion, a credit positive for the state and for local governments that participate in SCRS. Actuaries project that benefit changes and increased employee contributions under the law will reverse liability growth and reduce state and local government contributions requirements over time.

An actuarial assessment by Gabriel Roeder Smith & Co.[14] showed the SCRS funded ratio (the plan's actuarial assets compared with liabilities) rose to 67.4% from 64.0% as of 1 July 2011 because of the reforms that Governor Nikki Haley signed late last month. Like many US public pensions, South Carolina's plans lost ground in recent years because of weak investment performance and benefit enhancements. The projected SCRS unfunded liability (accrued liability less actuarial assets) falls below what it would have been absent the reforms, by amounts ranging from 14% in the early years to 79% in 2041 (see exhibit), according to the actuarial study.

Projected South Carolina Unfunded Liability Falls Significantly from Pre-Reform Levels



Source: Gabriel Roeder Smith & Co., Analysis of H. 4967 as Enacted

Most of the liability reduction stems from changes to benefit policies, particularly those that let participants keep working after beginning to collect pension benefits. Under the reforms, plan participants would face a 30-day service break requirement before returning to work and would see pension benefits suspended if they earn more than $10,000 in a year. The Teacher and Employee Retention Incentive (TERI) program that allows retired members to accumulate annuity benefits on a deferred basis for five years while continuing to work will be phased out.

The legislation also blocks employees from disability retirement simply because they are unable to perform a given job. Cost-of-living adjustments (COLAs) for current retirees will be capped at the lesser of 1% or $500 annually.

[14] Analysis of H. 4967 as Enacted and its Financial Impact on SCRS, Gabriel Roeder Smith & Co., 2 July 2012.

Because the law raises employees' required SCRS contribution share, state and local government employers will face more modest contribution increases. Workers' contribution rates will rise to 8% of their salaries from 6.5% during the next three years, while their employers' share will increase to 10.9% from 10.6%. The maximum employer rate projected now is 11.1%, down from 14.7% before. As a result, the projection shows state and local government pension contributions to SCRS falling by $1.25 billion, or 16%, over the next six years, with annual savings starting next fiscal year, at $147 million. The projection assumes a 7.5% annual return on plan investments.

South Carolina's pension reform law requires that employer contribution rates stay at a 2.9% increment over employee rates. Any funding burden increase (because of benefit enhancements or investment underperformance) would consequently be shared equally by governments and workers. Contribution rates must be at the level needed for 30-year liability amortization, and the law also prohibits contribution rate decreases until the plan is 90% funded.

The state's actuarial firm also estimated that the legislation increases the Police Officer Retirement System (PORS) unfunded liability to $1.4 billion from $1.1 billion. The PORS liability increase reflects the inclusion of new mandated COLAs (at the lesser of 1% or $500), because PORS COLAs previously were provided only on an ad hoc basis.

The law contained other provisions, such as a new tier for incoming workers, that do not affect the actuarial accrued liability or contribution rate as of the valuation date, but will change long-term costs. New employees are subject to more stringent retirement eligibility requirements and other cost controls, such as determining final compensation based on the average of five years rather than three.